BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
W. W. TOUCHSTONE)

Appearances:

For Appellant: Paul E. Iverson, Attorney at Law.

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; Harrison Harkins, Associate Tax Counsel.

O P I N I O N

This appeal is made pursuant to Section 19 of the Personal Income Tax Act (Chapter 329, Statutes of 1935, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of W. W. Touchstone to a proposed assessment of additional tax in the amount of $156.57 for the year ended December 31, 1935.

During the year in question the Appellant was a partner in the firm of Touchstone and Touchstone. The proposed assessment resulted from the action of the Commissioner in including in the partnership income for the year 1935 the profit derived from the sale of certain real property. The agreement for the sale of the property was entered into by the partnership and the purchaser on December 31, 1934. It acknowledged the receipt of the sum of $4,250 from the buyer as a part of the purchase price, that sum, however, to be returned to the buyer in the event that title to the property was not acceptable to him. It also provided for the deposit in escrow on that date of a check in the amount of $20,000, the proceeds to be turned over to Touchstone and Touchstone when title was acceptable to the buyer. The latter agreed to pay within 90 days, as the balance of the purchase price, an additional sum of $10,000, together with interest thereon at 6 per cent. The agreement also provided that taxes, insurance and rents were to bc pro-rated as of December 31, 1934. In January, 1935, the buyer found the title to be satisfactory, and the property was conveyed to him.

In support of his position that the gain from this transaction was realized until 1935 the Commissioner relies upon Helvering v. San Joaquin Fruit and Investment Co., 297 U. S. 496, and Lucas v. North Texas Lumber Co., 281 U. S. 11. The former case held that within the meaning of Section 204(a) of the Revenue Act of 1924

real property in California was "acquired" in the year in which the lessee thereof, pursuant to the provisions of the lease, exercised an option for its purchase, rather than the year in which the lease was executed. In view of the different factual situation involved, we do not regard this case as having any bearing on the question presented herein. Here the agreement of December 31, 1934, did not give the purchaser a mere option, but created obligations binding upon both the purchaser and the seller. The fact that the contract required the title to be "acceptable" to the buyer did not authorize the latter to reject the title without just cause. See Benson v. Shotwell, 87 Cal. 49; Karahadian v. Lockett, 33 Cal. App. 411.

In the other case cited by the Commissioner, Lucas v. North Texas Lumber Co., the taxpayer, on December 27, 1916, had granted a ten-day option for the purchase of certain land. On December 30, the holder of the option advised the seller that it would exercise the option, and on January 5, 1917, the papers required to effect the transfer were delivered and the purchase price paid. Although it appeared that there was at no time any question as to the buyer's ability to complete the transaction, the court held that the gain from the sale did not accrue until 1917. The reasoning of the Court and the particular facts upon which the decision rested are disclosed by the following excerpt from the opinion:

> "In the notice the purchaser declared itself ready to close the transaction and pay the purchase price 'as soon as the papers were prepared.' Respondent did not prepare the papers necessary to effect the transfer or make tender of title or possession or demand the purchase price in 1916. The title and right of possession remained in it until the transaction was closed, Consequently, unconditional liability of vendee for the purchase price was not created in that year." 281 U. S. at 13.

It is apparent from this language that a decisive factor in the mind of the Court was the circumstance that under the specific terms of the acceptance the purchaser was under no obligation to pay any amount to the seller until the latter had prepared the papers required to effect the transfer. Here, on the other hand, upon the execution of the agreement the purchaser paid a substantial portion of the price to the seller and deposited a further amount in escrow, and obligated himself to pay the balance within 90 days.

Under Article 36-1 of the Regulations Relating to the Personal Income Tax Act income accrued prior to January 1, 1935, is not taxable. Income had generally been held to accrue when the right to it arises, even though immediate payment is not due or anticipated, provided there is a reasonable expectation that payment

will ultimately be received. Continental Tie and Lumber Co. v. United States, 286 U. S. 290, Helvering v. Russian Finance Construction Co., 77 Fed. 2d. 324, 327; United States v. Utah-Idaho Sugar Co., 96 Fed. 2d. 756, 758, cert. den., 305 U. S. 631.

Although there was a possibility that the sale would not be completed due to the inability of the seller to furnish a satisfactory title, it is to be observed that the seller had recently secured a policy of title insurance on the property. In Hannah v. Commissioner, 31 B. T. A. 971, an agreement to bring suit to perfect title to the land being sold was held not to prevent the accrual of income from the transaction when it appeared that there was only a remote contingency of invalid title. The situation involved herein falls, in our opinion, within the principles set forth in these authorities.

It is to be noted that in cases subsequent to the North Texas case, the Federal Courts have held that the accrual of gain from the sale of real property does not depend upon the conveyance or upon the delivery of the documents of title (Helvering v. Nibley-Mimnaugh Lumber Co., 70 Fed. 2d. $43; Commissioner v. Union Pac. R. Co., 86 Fed. 2d. 637); not is it affected by the fact that in the event of a defect in the title the buyer could have refused to carry out the contract and recovered ail amounts paid by him. (Helvering v. Nibley-Mimnaugh Lumber Co., supra). While it does not appear that here, as in those cases, the purchaser took actual physical possession of the property on the day the contract was executed, under the contract he was entitled after that date to receive the benefits and required to assume the burdens of ownership, and under these circumstances we think it is proper to regard him as the beneficial owner of the property. See Hanvens v. Alameda County, 30 Cal. App. 206.

O R D E R

Pursuant to the viewsexpressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Charles J. McColgan, Franchise Tax Commissioner, in overruling the protest of W. W. Touchstone to a proposed assessment of an additional tax in the amount of $156.57 for the taxable year ended December 31, 1935, be and same is hereby reversed. Said ruling is hereby set aside and the Commissioner is hereby directed to proceed in conformity with this order.

Done at Sacramento, California, this 2nd day of December, 1942, by the State Board of Equalization.

R. E. Collins, Chairman
George R. Reilly, Member
Wm. G. Bonelli, Member

ATTEST: Dixwell L. Pierce, Secretary